The latest Biden tax proposal

The new budget proposes changes to the top tax rate and the estate tax exemption.

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Key takeaways

- The Biden administration has proposed raising the top individual income tax rate, reducing the estate tax exemption, and adding a 20% minimum tax on those with a net worth greater than $100 million.
- The proposed changes are targeted at the top 1.8% of American taxpayers, but are unlikely to pass into law given obstacles in Congress.
- Still, it may be wise to consider certain strategies in anticipation of a future high-tax environment.

On Monday, March 28, President Biden released his proposed budget for 2023, calling for $5.8 trillion in spending to support the administration's goals on defense, health care, climate change, and infrastructure. Though the budget is less ambitious in scope than the now-stalled Build Back Better Act (BBBA), it does include some of the same revenue-raising tax changes as the BBBA—and will likely face many of the same obstacles.

What's being proposed?

The budget proposal seeks to generate revenue by raising taxes on the wealthiest Americans:

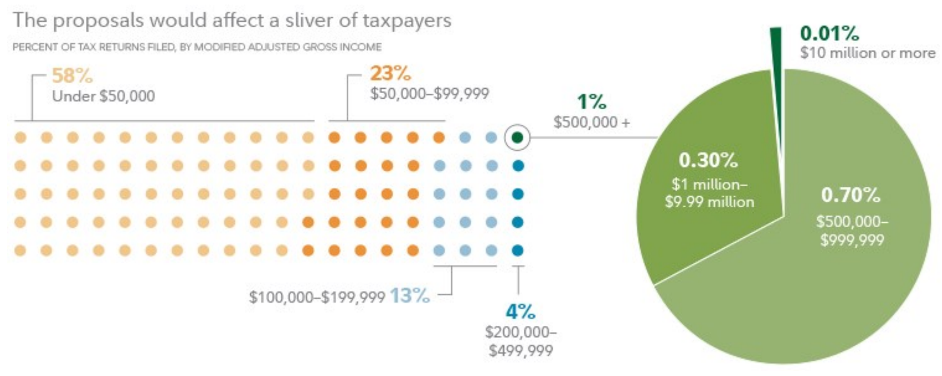
- **The top individual income tax rate** would rise to 39.6% from 37% for income above $400,000 (single filers) or $450,000 (married filing jointly).
- **Qualified dividends and long-term capital gains** would be taxed as ordinary income, plus the net investment income tax, for income that exceeds $1 million.
- **Transfers of property** by gift or death would trigger a tax on the asset's appreciated value if in excess of the applicable exclusion.
- **The estate tax exemption** would be reduced from $12.06 million (in 2022) to $5 million, indexed for inflation.

For taxpayers with a net worth greater than $100 million, a 20% minimum tax would be imposed on total income, including unrealized gains.

The budget would also eliminate the ability to defer gains on the like-kind exchange of real property, modify the rules relating to grantor trusts, and impose limits on the duration of generation-skipping trusts. "These would be meaningful changes for trusts and estates," says David Peterson, head of Wealth Planning at Fidelity. "More family wealth would be taxed, and fewer assets would be transferred to the next generation."

Who will be affected?

Generally speaking, the income tax changes laid out in the budget would impact a very small number of taxpayers if they were implemented. The increase in the top marginal income tax rate would affect about 1.8% of Americans, while the proposed tax on total income and unrealized gains would only affect the top 0.01%.



What is the likelihood that this becomes law?

Presidential budgets are largely symbolic. “Every year, the current administration puts out a budget proposal to express their policy priorities that lays out a wish list on what they’d like to accomplish,” says Alice Joe, a vice president on Fidelity’s Government Relations team. “Elements of it can get incorporated into various bills, but the president’s budget as a whole is rarely, if ever, turned into law.”

As with the BBBA, Congress would have an opportunity to determine what goes into the final budget, and it’s highly unlikely that the final product would resemble the proposed budget.

This proposal would face many of the same obstacles that faced the BBBA, plus an additional one: Because the proposal includes policies that are not directly related to taxes and spending, it would not be possible to pass it using the reconciliation process. This means it would need to garner 60 votes in the US Senate to proceed — no easy task given that the chamber is divided 50-50 between Democrats and Republicans.

Joe views the proposed budget primarily as a messaging tool to Democratic legislators and voters. “You’ll note that the baseline used in the proposal is the House-passed version of the BBBA, as if it was already enacted into law. It’s a reminder to Congress that the administration still wants to get the BBBA over the goal line this year,” says Joe.

How should you prepare?

Though President Biden's proposed budget isn't expected to pass into law, some of its tax provisions are going to happen anyway in a few years. The reduction of the top marginal income tax rate to 37% and increase of the estate tax exclusion amount were brought into effect by the Tax Cuts and Jobs Act (TCJA) of 2017 and are scheduled to sunset at the end of 2025. This means that unless Congress acts to extend those provisions of the TCJA, the top rate will jump back to 39.6% and the estate tax exclusion will fall to an inflation-adjusted $5 million. The Biden budget simply proposes to do this sooner, in 2023.

"While we don't expect these changes to come into effect next year, it's still worth considering what strategies might make sense in a higher tax environment," says Greg Doyle, a vice president on Fidelity's Advance Planning Team. Doyle points to 4 strategies that could potentially help minimize your tax burden and facilitate wealth transfer to the next generation should income taxes increase:

- **Roth IRA conversions:** If you are likely to be affected by the increase in the highest marginal income tax rate, converting a traditional IRA to a Roth IRA now, when the rate is still relatively low, could be advantageous. A Roth IRA can help provide tax-free growth potential and tax-free withdrawals in retirement or for your inheritors, especially if they live in high-tax states like New York or California.
- **Bunching charitable deductions:** If you itemize your deductions and plan on making a large charitable gift, it may make sense to defer that gift if you expect to be in a higher tax bracket in the next year.
- **In-kind transfers:** If you have a grantor trust, you may want to consider moving high-cost-basis assets into your trust and taking low-cost-basis assets of equal value out. Bringing those low-basis assets back into your estate will allow your spouse or children to "step-up" the basis of the assets to the fair market value when they inherit them, offering a substantial savings on capital gains taxes.
- **Tax-smart strategies:** Investors of every income level can implement strategies designed to help manage, defer, or reduce taxes, such as tax-smart asset location and tax-loss harvesting.

A good opportunity to reassess

Doyle suggests that while there may not be any immediate need to make a change to your plan, it's never a bad time to assess your situation. "This could be a good time to revisit your plan, and test assumptions around your tolerance for risk and your time horizon," he says. "Having a plan in place that's designed for the long term can help you avoid making reactionary decisions that could lead you to miss out on potential growth."

"Taxes are just one consideration when making decisions about your portfolio," says Peterson. "It's best to stay focused on your long-term goals while building flexibility into your plans and into your mindset."

As always, before you consider making any changes to your personal plan, make sure to look at your whole financial picture and consult your tax advisor.